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State agency solve the budget deficit by raising taxes?

Obscure rule governing Board of Equalization allows them to extend sales tax from goods to services.

BRIAN JOSEPH CAPITOL WATCHDOG

SACRAMENTO In case you haven't heard, the state is in trouble. Projections now put the budget deficit at \$17 billion. Democrats don't want to cut services. Republicans don't want to raise taxes. Another legislative battle awaits.

Or does it?

Through some research, I've learned of a way Democrats could, hypothetically, sidestep the state Legislature and raise taxes to solve the deficit.

"It is very scary," said Michelle Steel, Orange County's representative on the state's little-known tax collecting agency, the Board of Equalization. "We cannot just change the rule and go a different route."

The whole scenario hinges on an obscure definition of what's taxable in California and an even more obscure rule governing the board. As I've reported, sales tax in California only applies to goods, like vacuum cleaners and T-shirts. It doesn't apply to services, like attending a ballgame or hiring an accountant to do your taxes.

The Board of Equalization, however, could change that. Buried in its rules is a provision that says any person can "petition the board to adopt, amend or repeal a regulation" and the board has to respond within 30 days.

All someone would have to do is petition the board to change the definition of what's taxable to include services and – Voila! – the budget debate has moved from the Legislature to the Board of Equalization.

Now, Republicans on the board would likely oppose this move, but they could do little to stop it. Of the board's five members, only two are Republicans. And unlike the Legislature, where major decisions require a 2/3rds majority, and thus some Republican support, the board only needs three votes to pass anything. What's more, the board's chairwoman, Judy Chu, has already proposed a 5 percent sales tax on services that she says would generate \$8 billion annually for the state.

"Extending the sales tax to services would modernize our sales tax base to better reflect commerce in the 21st century, and stabilize state General Fund revenues, which are prone to cyclical fluctuations," Chu said in an April 22 statement about the proposal.

And don't think this is just some crazy, pie in the sky thing. The same thing happened last year when the board changed the definition of flavored malt beverages so they could be taxed at the higher hard liquor rate rather than the lower beer one.

"It's possible it's going to come up," Steel said.

Chu's office told me it plans to work with the Legislature rather than try to extend the sales tax through the Board of Equalization, but she's hardly the only one thinking about this. Annette Nellen, a San Jose State tax professor and a fellow at the New America Foundation, wrote in a recent study of the state's tax base that "(T)here is no reason to tax laundry detergent, but not dry cleaning services."

Lenny Goldberg, executive director of the California Tax Reform Association, recommends taxing services in a 2005 report on the structural deficit. Even the governor's office has reportedly explored taxing lawyer and account services as well as golf lessons and sessions with personal trainers.

And thanks to the board's obscure rule, it could all be enacted without a single Republican vote.

"The Board of Equalization has the authority to make this determination on its own," said Democrat Charles Calderon, chairman of the Assembly Revenue and Taxation Committee, in a recent hearing on a similar proposal to extend the sales tax to digital downloads.

"They are as much elected representatives of this state as any (legislator) and they have as much of a responsibility in term of enforcing our laws and bringing in the revenue that the state needs to function."

Goldberg said he's considered petitioning the board, but warned that would probably result in only a limited expansion of sales tax. Because current law says sales tax can only be applied to tangible goods that you can see or touch, Goldberg said he thought someone could only petition the board to expand the sales tax to things like admission tickets or greens fees -- not labor services.

And even if the board acted, he suspects the issue would be tied up in courts for years.

"(You'd have) a whole lot of people with a whole lot of money stirring up a whole lot of opposition," he said.

So will it happen? I don't know, but the pressure is on. Some estimate the state will be out of money by August and Sacramento is desperate for a fix.

As Gov. Arnold Schwarzenegger has said, "Everything is on the table."

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